



THE CHAIRMAN

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

January 5, 2000

The Honorable John D. Dingell
Ranking Member
Committee on Commerce
U.S. House of Representatives
2322 Rayburn House Office Building
Washington, DC 20515-6115

RE: GAO's Report Concerning SEC and SRO Fine Collection Rates

Dear Congressman Dingell:

In a November 23, 1998 letter regarding the General Accounting Office ("GAO") report, Money Penalties: Securities and Futures Regulators Collect Many Fines But Need to Better Use Industrywide Data (GAO/GGD 99-8, Nov. 2, 1998), you requested that we report back to you within a year regarding progress in implementing certain GAO recommendations. In particular, the GAO recommended that the Securities and Exchange Commission ("SEC") analyze industrywide information on disciplinary program sanctions, particularly fines. The GAO further recommended that the SEC encourage the securities self-regulatory organizations ("SROs") to maintain automated records of their fine collection activities that are appropriate for the number of fines they impose. You also requested that we evaluate the SEC's and the SROs' fine collections rates for 1997-1998 and indicate the extent to which the SEC uses centralized debt collection facilities.

SRO Disciplinary Program Sanctions

The SEC's Office of Compliance Inspections and Examinations ("OCIE") is currently developing a database to serve as a repository for information concerning disciplinary awards and fines levied by the SROs. Each SRO forwards to OCIE, pursuant to Rule 19d-1 of the Securities Exchange Act of 1934, a hardcopy of all disciplinary decisions. OCIE currently maintains limited information concerning each decision in a Microsoft Access database. The inspections staff is working to expand the database to include sufficient and comparable information regarding each decision that may assist the staff in analyzing trends and identifying disparities in sanctions among SROs. OCIE is also recommending through the inspection process that SROs discuss creating a joint SRO disciplinary database. Additionally, OCIE continues to review SRO disciplinary sanctions and fines in regular inspections of each of the SROs' disciplinary programs.

SRO Fine Collection

With respect to fines imposed in 1997 and 1998, the fine collection rates overall for the securities SROs have increased from the prior five-year period. In its report, the GAO examined the collection rates of five of the SROs from 1992 to 1996: the American Stock Exchange ("AMEX"), the Chicago Board Options Exchange ("CBOE"), the Chicago Stock Exchange ("CHX"), the National Association of Securities Dealers ("NASD"), and the New York Stock Exchange ("NYSE"). As set forth in the table below, the Amex, CBOE, CHX, and NYSE fine collection rates increased in 1997 and 1998 over the prior review period. The fine collection rates decreased at the CHX¹ and the NASD.

Entity	1997-1998 Fine Collection Rate	1992-1996 Fine Collection Rate
AMEX	100%	75%
CBOE	98.7%	95%
CHX	95.3%	100%
NASD	18.5%	24%
NYSE	100%	98%

Table 1: Comparison of Fine Collection Rates

The NASD's fine collection figure only includes fines that were paid in full by respondents. The NASD's rate for 1997-1998 does not include fines paid on an installment basis that have not yet been fully paid.²

The NASD recognizes that its fine collection rate is low in comparison to the total amount of fines ordered. The NASD stated that, as the total dollar amount of fines assessed in the NASD's program has increased dramatically in the past several years, there has not been a corresponding percentage increase in collected amounts. The NASD also explained that its disciplinary decisions imposing monetary sanctions are not self-enforcing and that when a respondent has left the securities industry, the NASD has no authority to collect the amounts owed.³ Since 1995, the

¹ According to the CHX, the decrease was due primarily to two minor rule violation cases where the CHX members lost their exchange seats so collection efforts ceased. These two cases represented 69% of the CHX's uncollected fines. Also note that the total fines levied at the CHX for 1997-1998 were \$77,000 and that only \$3,600 went uncollected.

² The NASD's computerized fine tracking system only marks a fine paid when it is fully paid. We also note that the NASD figure represents the total amount of fines the NASD collected in full versus the total amount of fines the NASD actually ordered. In particular, the NASD often, as part of a settlement agreement, waives collection of a fine unless or until the respondent attempts to re-enter the industry. The waived fines were excluded from the calculation. Additionally, the NASD stated that it inadvertently underestimated the amount of fines it waived. Accordingly, the NASD believes the percentage of fines it collected from the total that is actually due and payable is considerably higher than what is reflected. The NASD is in the process of reconciling these numbers.

³ Because of the limitations on the NASD's authority, in a recent case, the SEC obtained a federal court order pursuant to Section 21(e)(1) of the Securities Exchange Act of 1934 requiring a respondent who had left the industry to pay the NASD sanction. *See SEC v. French*, Misc. No. 99-0826 (E.D. La. May 6, 1999). The SEC staff now plans to request SEC authority to seek similar court orders in other cases. The NASD will then be able to collect its unpaid sanctions by enforcing these Section 21(e)(1) orders in court.

number of individuals barred or suspended by the NASD has grown to more than 650 each year. In light of the disparity between the amount of fines due and payable and the amount collected, the NASD has undertaken a study of its fine imposition and collection policies and procedures. Based on NASD staff recommendations following the GAO's Report, NASD Regulation's ("NASDR's") National Adjudicatory Council set up a task force in November 1998 to review NASDR's policy on the imposition, suspension, and collection of monetary sanctions.⁴ The task force recognized that, based on experience, there were certain types of fines that were unlikely to ever be collected and that this directly contributed to the growing gap between fines imposed and fines collected. In response, the task force identified certain violations in this group and concluded that fines would not be imposed based on these violations when a respondent is barred and where there is no widespread customer harm. NASDR has stated that its new policy is guided by the following principles:

- In certain categories of cases—such as failure to respond to staff requests for information, exam cheating cases, conversion, and forgery—if an individual is barred, NASDR generally will not also impose a fine.
- Where quantifiable customer harm has been demonstrated, or a respondent has been unjustly enriched, NASDR generally will order restitution and disgorgement.
- In sales practice cases where there has been widespread, significant, and identifiable customer harm or the respondent has retained substantial ill-gotten gains, NASDR generally will require the payment of restitution and disgorgement and will also pursue the collection of any fine.
- Where there has been no widespread customer harm, and individuals are barred or suspended, NASDR may forego the imposition of a fine and require that any order of restitution or disgorgement be satisfied upon the individual's re-entry into the securities industry. This will allow NASDR to act quickly to get those persons out of the industry.
- NASDR will consider a respondent's inability to pay when imposing monetary sanctions.

According to the NASDR, it is examining the extent of its legal authority to collect fines, disgorgement, and restitution owed. In addition, discussions between the NASDR and a national debt-collection firm are now underway. It is anticipated that the NASDR will engage an outside collection firm to actively pursue outstanding money obligations growing out of disciplinary proceedings. These discussions are ongoing.

We also examined the fine collection rates for four additional SROs during the period 1997-1998: the Boston Stock Exchange ("BSE"), the Cincinnati Stock Exchange ("CSE"), the Pacific Exchange ("PCX"), and the Philadelphia Stock Exchange ("Phlx"). The BSE, CSE, and

⁴ Over the past several months, this task force met on a regular basis with representatives from the NASD's Office of General Counsel, Office of Disciplinary Affairs, and Departments of Enforcement, Member Regulation, and Market Regulation.

Phlx had a 100% fine collection rate in 1997-1998. The PCX fine collection rate was 95.9% for the period.⁴

SEC's Fine Collection

The GAO reported that 83% of fines and penalties in cases closed between 1992 and 1996 had been collected. For cases closed during the years 1997-1998, the SEC collected 75.9% of fines or penalties. These figures do not include a number of open matters in which the SEC continues actively to pursue payment in litigation.

The figures also do not include unpaid judgments that have been referred to the Department of Treasury, Financial Services Division. The SEC refers all unpaid judgments to Treasury, after it has exhausted its efforts to collect penalties. The Financial Services Division of Treasury has official responsibility for collection of unpaid judgments owed to the United States Government. Only after the Financial Services Division has completed its efforts and determined that the judgment is uncollectible does the SEC consider whether a case should be closed.

Automation

The SEC and all but one of the SROs maintain automated records of their fine collection activities. The SROs' automated systems are generally run on accounting-based software. For instance, the NYSE records each fine in the general ledger of the NYSE and records the details of each fine on an Excel spreadsheet. The two are reconciled and reviewed on a regular basis. The CSE does not have an automated system. This exchange, however, is small and has few disciplinary cases.⁵ Given the small number of disciplinary cases administered, we believe the manual tracking of fines at the CSE is appropriate.

We also note that the PCX is preparing to automate its method of collecting fines. Effective January 2000, the PCX is requiring all members to have their fines paid automatically through the National Securities Clearing Corporation or the Options Clearing Corporation. The National Securities Clearing Corporation or the Options Clearing Corporation will collect the PCX fines as part of their standard collection process. OCIE believes this process is an effective means to timely collect fines.

⁴ See Exhibit A. As indicated in the chart, we analyzed the total dollar amount of fines imposed and collected.

⁵ The CSE administered nine disciplinary actions during 1997-1998.

We hope this information proves helpful and demonstrates our commitment to effective disciplinary programs.

Sincerely,

A handwritten signature in black ink, appearing to read 'A. Levitt', written over a horizontal line.

Arthur Levitt
Chairman

Cc: The Honorable Tom Bliley, Chairman
Committee on Commerce

The Honorable David Walker, Comptroller General
General Accounting Office

Summary of SEC and SRO Fine Collection Rates for 1997-1998

ENTITY	AMOUNT ORDERED	AMOUNT COLLECTED	COLLECTION RATE	AUTOMATION	NOTES
SEC	\$ 65,667,440	\$ 49,855,788	75.9%	Y	1
AMEX	\$ 923,759	\$ 923,759	100.0%	Y	
BSE	\$ 1,200	\$ 1,200	100.0%	Y	
CBOE	\$ 1,501,679	\$ 1,482,496	98.7%	Y	
CHX	\$ 77,000	\$ 73,400	95.3%	Y	
CSE	\$ 20,000	\$ 20,000	100.0%	N	
NASD	\$ 90,334,292	\$ 16,698,160	18.5%	Y	2
NYSE	\$ 5,032,500	\$ 5,032,500	100.0%	Y	
PCX	\$ 192,207	\$ 184,407	95.9%	Y	
PHLX	\$ 90,123	\$ 90,123	100.0%	Y	

Fine amounts ordered excludes costs and disgorgements.

NOTES

Note 1: The SEC figures include all cases closed from January 1, 1997 through December 31, 1998.

Note 2: The NASD collection rate represents the total amount of NASD fines collected versus the total amount of NASD fines sought. The NASD often, as part of a settlement agreement, waives collection of a fine unless or until a respondent re-enters the industry. Waived fines were excluded from the total amount ordered. The NASD also represented that it believes it has underestimated the amount of fines where collection was waived. Additionally, the NASD computerized tracking system only marks a fine paid when it is fully paid. Accordingly, the amount of NASD fines collected does not include fines that are being paid on an installment basis, but that have not been fully paid.